



**MINUTES FROM MEETING OF THE
INVESTMENT COMMITTEE OF THE
PLANS MANAGEMENT BOARD
MAY 22, 2018**

The Investment Committee (the “Committee”) of the Plans Management Board (the “Board”) held a meeting on May 22, 2018 at the Office of the State Treasurer’s in the Carvel State Building located at 820 N. French Street Wilmington, Delaware.

Committee Members Represented or in Attendance:

Mr. Alan Colberg, Committee Chair

The Honorable Kenneth Simpler, State Treasurer

Mr. Robert Scoglietti, Director of Policy and External Affairs, Office of Management and Budget (on behalf of Director Jackson)

Ms. Stephanie Scola, Director of Bond Finance, Department of Finance (on behalf of Secretary Geisenberger)

Mr. Todd Roselle, Committee Member

Mr. Porter Schutt, Committee Member

Committee Members Not Represented or in Attendance:

Mr. Jose Echeverri, Committee Member

Others in Attendance:

Mr. Jason Staib, Deputy Attorney General, Delaware Department of Justice

Ms. Nora Gonzalez, Deputy State Treasurer, OST

Mr. John Meyer, Director of Contributions and Plan Management, OST

Mr. Mike Green, Investments and Operations Manager, OST

Mr. Daniel Kimmel, Promotion and Outreach Manager, OST

Mr. Omar Masood, Policy Advisor, OST

Mr. Earle Allen, Cammack Retirement Group (“Cammack”)

Ms. Denise Burns, Cammack

Ms. Marie Villeneuve, Cammack

Mr. Justin Rozzero, Fidelity Investments (“Fidelity”)

Mr. Peter Walsh, Fidelity

CALLED TO ORDER

The meeting was called to order at 10:03 a.m.

INTRODUCTIONS

Committee members and others present introduced themselves.

Committee Members' Designees

Mr. Colberg presented Bert Scoglietti of the Office of Management and Budget as designee for Director Jackson and Stephanie Scola of the Department of Finance as designee for Secretary Geisenberger.

APPROVAL OF COMMITTEE MEMBER DESIGNEES

A MOTION was made by Treasurer Simpler and seconded by Mr. Roselle to approve Bert Scoglietti and Stephanie Scola as members of the Committee.

MOTION ADOPTED UNANIMOUSLY

There was a brief discussion about creating a Committee vice chair. Mr. Colberg solicited potential candidates and instructed interested parties to reach out to Mr. Meyer.

MINUTES

Mr. Colberg presented the minutes from the February 20, 2018 meeting. Treasurer Simpler requested a minor change to one word in the section about Fidelity's presentation, changing the word "constructive" to "positive" to achieve greater clarity in terms of what Fidelity intended to convey. There were no objections.

APPROVAL OF MINUTES

A MOTION was made by Mr. Schutt and seconded by Mr. Roselle to approve the revised minutes.

MOTION ADOPTED UNANIMOUSLY

PRESENTATIONS

Investment Performance on College Investment Plan by Fidelity

Mr. Rozzero informed the Committee that Fidelity was working with OST to revise and improve the investment reporting materials. A new presentation package was in development and Fidelity would be interested in feedback from the Committee. Mr. Meyer asked Mr. Green to circulate a draft presentation to the Committee.

Mr. Walsh led a discussion of 1st Quarter 2018 investment results. Mr. Walsh said January opened the year with strong equity performance, but February featured significant volatility. Overall, Mr. Walsh described the quarter as a weak one for stocks and bonds due to volatility in the market caused by concerns of inflation and trade wars.

Mr. Walsh reported highlights from the reporting period. The majority of the age-based and static portfolios outperformed their respective benchmarks. The conservative portfolio underperformed in the quarter compared to the benchmark. Mr. Walsh stated that index portfolios performed in line with expectations.

Mr. Walsh stated positive absolute performance across all age-based and static portfolios over the 1 year, 3 year, 5 year and life of fund periods.

Mr. Schutt asked if there is a difference in fees among the types of portfolios. Mr. Walsh replied the index options are the least expensive at 11-12 basis points and the multi-firm options have the highest fees. He said the Fidelity age-based portfolio is in the 53-99 basis point range. The multi-firm options are in the 89-116 basis point range for expenses.

Mr. Walsh described Fidelity's investment policy and the firm's goal to achieve savings of 50% of the cost for a public four-year college. He then turned to discussing Fidelity's active allocation set up and the team's goal of being dynamic, flexible and looking at 24-36 month horizons.

Mr. Walsh said Fidelity feels interest rates will rise and Fidelity will move away from their overweight in equities to more inflation-fighting asset classes to protect positions. Mr. Walsh indicated Fidelity is still bullish on emerging markets. Mr. Schutt asked what inflation-sensitive vehicles are being considered. Mr. Walsh replied they would be using commodities, floating rate, and real estate as their inflation fighting options.

Mr. Schutt asked for detail on the active allocation methodology and how the investment team makes decisions. Mr. Schutt requested Fidelity to walk through their internal thought process and stated that the Committee also has to assess people, process, and philosophy. In particular, Mr. Schutt inquired about the makeup of the Fidelity team developing the glide path philosophy and the tenure of the team. Mr. Walsh suggested a follow up call with one of the portfolio managers or to add the topic to a future Committee meeting agenda.

Mr. Walsh explained how the composite benchmark will vary over time as a beneficiary approaches college age. As an example, Mr. Walsh pointed out that for (the 2036 portfolio) the composite is weighted as 66% Dow Jones US Total Stock Market, 28.5% Morgan Stanley Capital International All Country World Index (MSCI ACWI), 5% Bloomberg Barclays US Aggregate Bond Index (BBg Barc USAGG Bond), and zero cash or the BBg Barc 3m T-Bill). For the 2021 portfolio, the respective composite benchmark weights would be 23.9%, 10.2%, 47%, and 17.9% respectively.

Treasurer Simpler said while it is easy to develop benchmarks the more complex undertaking is assessing how peer classes compare to other peer classes. Treasurer Simpler inquired about how the Committee should define a peer class. Treasurer Simpler spoke of comparing Delaware's investments to others in the market, particularly plans rated gold or silver by Morningstar. Treasurer Simpler noted the dominance of target-date funds in the 529 market. Mr. Walsh mentioned the average rankings per Morningstar rankings for the three different funds (active, index, multi-firm) and by age vintage. Treasurer Simpler asked for more information on the universe of fund families.

Mr. Scoglietti asked why the index age-based and static portfolios were performing below the composite benchmark. Mr. Walsh replied the difference is really construction of the benchmark. For example, Vanguard does not use commodities and uses the Russell 2000 rather than the Dow Jones.

Mr. Schutt asked if Fidelity takes active bets on or around value and growth. Mr. Walsh responded that they do not. Fidelity uses active allocation based on the glide path, which is built around strategic asset classes.

Investment Performance on Deferred Compensation Plans by Cammack

Ms. Villeneuve reported approximately \$750 million in total assets across the three plans on the Voya recordkeeping platform. Ms. Villeneuve also reported total contributions of \$60 million in the quarter. She stated the weighted average expense ratio was 35 basis points, which was slightly higher than the average of 32 basis points for public plans in the same size category according to the National Association of Government Defined Contribution Administrators survey. Ms. Villeneuve noted Delaware recently moved into the higher asset size class and that Delaware's suite is actively managed, which brings additional costs. Ms. Villeneuve reported a temporary recordkeeping fee reduction to 7.6 basis points for 2018 due to penalties triggered by performance guarantees.

Ms. Villeneuve reported target-date funds account for 78% of plan assets. A majority of target-date fund vintages are in the top quartile. Ms. Villeneuve and Ms. Burns discussed the reasons why American Funds target-date

family was selected. Treasurer Simpler said there was a bias towards moderate growth in that selection because of the presence of defined benefit pensions for State employees.

Ms. Burns acknowledged difficulties associated with how to assess target-date funds, which she expects to be about 75% of all industry retirement fund assets by 2020. Mr. Schutt asked what the current percentage is for the industry and Ms. Burns replied approximately 50%.

Ms. Burns walked the Committee through the composition of target-date funds, including at each points in the life cycle of specific funds. Mr. Green spoke about how American Funds' stock selection was a major factor in their selection. Ms. Burns then discussed what American Funds does well, that American Funds has low expense ratios and strong investment returns.

Mr. Schutt asked about how the investment managers are thinking beyond retirement. Ms. Burns replied the fund shifts all the way to age 95. The Committee discussed the increasing longevity among retirees and the need to prepare to have retirement funds last longer.

The Committee requested that American Funds present at a future meeting due to the large concentration of assets in the target date funds.

Ms. Villeneuve indicated Cammack will continue to recommend ClearBridge Midcap Growth ("ClearBridge") for the watch list. Ms. Burns provided an overview of the Templeton Global Bond Fund ("Templeton") and Lazard International Equity Portfolio ("Lazard"). Ms. Burns stated most of Templeton's performance has been derived from currency moves. Ms. Burns explained a fund such as Templeton would be more volatile but over time would provide value through differentiation from other funds in the portfolio

Ms. Burns reported that year-to-date the Lazard fund is up 77 basis points, which compares to 47 basis points for the benchmark and 95 basis points for the category. Ms. Burns attributed some of this to an overweight to developed markets. Ms. Burns described it as a fund one would want in a retirement fund because they focus on valuation in a set context.

Ms. Burns discussed the investment analysis scorecard. Treasurer Simpler requested a column showing what percentage of assets are in the specific funds as a percentage of Tier 2 assets.

Ms. Scola asked if the Committee needed a formal vote to continue ClearBridge being on watch. Mr. Colberg said the practice at his firm is to discuss a fund that has been placed on watch but not to take a formal vote at each meeting to continue the watch list status.

Committee members discussed having ClearBridge present to the Committee.

DISCUSSIONS

Investment Policy Statement ("IPS")

Mr. Meyer presented a draft IPS to the Committee. Mr. Meyer provided credit to Mr. Green and Mr. Staib for having helped draft the IPS. Mr. Meyer discussed the research process in developing the draft. Mr. Green reviewed the IPS documents from best-of-breed plans across the nation. The team also compared these with the present IPS. Mr. Meyer indicated OST hopes to finalize a draft IPS at the August Committee meeting. The Committee would then recommend approval of the IPS to the Board for the September 5th Board meeting.

Mr. Colberg stated that from a fiduciary standpoint there is no need at this point to approve a “final” IPS. Mr. Colberg expressed that having a written draft policy that can be used as guidance can suffice in the near term as the Committee works on finalizing the IPS. Mr. Colberg pointed out that the IPS may have to be tweaked over time and that there will be several iterations of the IPS over the next several years as things come up such as changes in regulations. Mr. Colberg encouraged a periodic review of the IPS.

Mr. Meyer walked the Committee through the content sections of IPS.

Mr. Meyer discussed the program design sections of the IPS. Mr. Meyer said the IPS could include hyperlinks to current investment lineups. Mr. Staib indicated it may be easier to have the lineup referenced in the IPS, with recognition that the exhibits can be changed. The fallback option is hyperlinking.

Mr. Meyer moved to a review of the program design features section. Mr. Meyer discussed the Committee’s ability, through recommendations to the Board, to restrict investment options offered via the self-directed brokerage windows. Mr. Staib referenced concerns Voya and Cammack had about the breadth of the language because the Board should not be conducting fiduciary oversight of individual brokerage options.

Treasurer Simpler spoke about the rationale behind selecting target-date funds and questioned whether that needed to be incorporated in the IPS. Ms. Burns replied she did not see a need to explicitly do so in the IPS because other methods to document the rationale would suffice. Mr. Staib said that fiduciary decisions have been documented. Mr. Staib suggested a periodic investment architecture review process to facilitate any need for revisions, although a specific timetable for the review would not be necessary. Treasurer Simpler revisited the issue of providing background on the rationale for the investment suite. Mr. Colberg stated he did not think that was needed in the IPS but wanted a discussion with Cammack on the drivers of the decision at the time which resulted in the investment selections. Treasurer Simpler said there was a separate Investment Array Committee as part of the deferred compensation RFP. Ms. Burns indicated that the RFP documents would provide context to the drivers. Mr. Allen also took the position that the historical thought behind the suite of investments is not necessary in the IPS. Mr. Allen then spoke about the importance of flexibility in the IPS.

Mr. Meyer gave an overview of the IPS section pertaining to target-date funds. Mr. Roselle asked if it would be beneficial to have the target-date suite in the IPS to cover what passes or fails as a category. Ms. Burns said they have not done that previously but could look into it.

Mr. Roselle asked whether the Committee is obligated to make a change if American Funds drastically underperforms. Ms. Burns responded that the Committee would have the right to make a change.

Mr. Colberg asked for “inception” to be reworded in the criteria to be something more like “the provider must have been in service for X years”.

Mr. Meyer discussed the watch list and miscellaneous provisions in the IPS. Mr. Staib spoke about the proxy voting and socially responsible investing provisions. Cammack and Ice Miller recommended taking the proxy voting language out and Mr. Staib agreed.

Mr. Staib shared that Ice Miller and Cammack had recommended removing the provision on excessive trading. Mr. Staib said the issue is addressed in the custodial agreement and trust agreement with Voya. Voya’s excessing

trading policy defines excessive trading as two round-trips within sixty days in a specific fund or six such trips over a year.

Mr. Schutt asked about socially responsible investing. Mr. Staib said he had a conversation with Mr. Colberg the previous day and both agreed that section should not be in the IPS. Mr. Colberg expounded by discussing the situation with the Department of Labor, which has suggested such investing currently could be vulnerable to a challenge on fiduciary grounds, although the Department of Labor has talked about developing a safe harbor to protect such investing in the future. Mr. Colberg reiterated that as of now there is no safe harbor protecting such investments. Mr. Schutt asked if any states are doing this. Mr. Allen said Texas will be rolling out socially responsible investing soon, and Ms. Burns added that religious-based investing has been around for a while. The Committee discussed the need for further review of the IPS and suggested that a redline version be circulated to members to provide further comments on during the month of June. The Committee suggested revisiting the IPS at the August meeting.

PUBLIC COMMENT

No members of the public attended the meeting.

NEXT MEETING

Mr. Meyer stated that the next Committee meeting is scheduled for August 21, 2018.

ADJOURNMENT

APPROVAL TO ADJOURN

A MOTION was made by Treasurer Simpler and seconded by Mr. Schutt to adjourn the meeting at 12:53 p.m.

MOTION ADOPTED UNANIMOUSLY

Respectfully submitted,

Alan Colberg,
Chair, Investment Committee